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JAMES H. McKENNE

(20,020.)

Supreme Court of the United States.

October Term, 1906.

No. 169.

JOHN W. CLARK,
Plaintiff in Error,

vs.

LOUIS GERSTLEY AND WILLIAM GERSTLEY,
Surviving Partners of the Firm trading as Rosskam, Gerstley & Company.

IN ERROR TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

BRIEF FOR PLAINTIFF IN ERROR.

LORENZO A. BAILEY,
For Plaintiff in Error.

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STATEMENT OF THE CASE.

This was an action of debt, begun in the Supreme Court of the District of Columbia, upon a conditional bond, dated September 11, 1903, in the penal sum of $5,000, wherein the plaintiffs (now defendants in error) are named as obligees and wherein the obligors are John F. Monaghan and J. Charles McGuire as principals and John W. Clark and William McGuire as sureties (R., 2).

The said bond which was filed with the declaration recites that the said principal obligors desire to purchase mer-

chandise from the plaintiffs "now and from time to time hereafter," which the said principals "have bound and hereby bind themselves to pay for in four months after the date of each respective purchase."

The condition is that the bond shall be void if the principal obligors shall pay "for merchandise now and hereafter so purchased the moneys due and to become due thereon when and as the same shall become due and payable."

The bond is therefore, by express terms, applicable only to goods purchased on four months' credit.

The declaration names all the obligors as defendants, states the substance of the obligatory clause of the bond, sets forth the condition (omitting the recital of the terms as to four months' credit), and then alleges the purchase thereafter by the principal obligors from the plaintiffs of merchandise amounting to $14,497.16, of which $9,100.48 have been paid, leaving overdue and unpaid $5,396.68, and claims damages in the sum of $5,000, with interest, etc.

The declaration does not set forth the terms recited in the bond or any terms of purchase, nor does it state when the charges for merchandise became due and payable, nor does it state that the merchandise charged for was sold on four months' credit or upon the terms stated in the bond.

The defendant Clark, a surety, filed seven separate pleas.

To all said pleas the plaintiffs demurred. The court sustained the demurrer. The said defendant Clark elected to stand upon his pleas, and thereupon judgment against him was granted to the plaintiffs for $5,000, with interest and costs (R., 10). Upon appeal by the said defendant Clark to the Court of Appeals of the District of Columbia, the said judgment was affirmed (R., 14), and he now prosecutes this writ of error.

The questions involved are as to the sufficiency of each plea and of the declaration itself. As the determination of these questions requires an examination of each plea sep-

arately, reference is hereby made to the record for that purpose (R., 5-9); the general nature of each being indicated as follows:

The first separate plea of the surety, Clark (R., 5, 6), alleges that under an agreement between him and the plaintiffs, he became such surety in consideration of their agreement with him that they would sell goods to the principal obligors, Monaghan & McGuire, at and for certain prices specified in said agreement, and allow them a continuous credit therefor in the sum of $10,000; but that after he became such surety the plaintiffs wrongfully refused, upon request, to sell the goods at said prices, or to allow the said credit, whereby the principal obligors were prevented from paying for the goods, etc.

This is a plea of set-off, and the bond in suit is therein alleged to have been given in performance of a certain prior agreement which does not appear to have been merged in the bond.

The second separate plea of the said surety (R., 6) alleges matter to discharge a surety, to wit, a certain other and independent agreement between the plaintiffs and the principal obligors for the sale of the merchandise referred to in the declaration and fixing the prices thereof and the terms of the sales; that afterward, in consideration of said agreement, he became surety in said bond; that thereafter the plaintiffs, without his consent or knowledge, entered into certain other agreements with said principal obligors, changing said terms and prices to his prejudice, and wrongfully refused to make the sales at said prices or upon said terms.

The third separate plea of the said surety (R., 6, 7) alleges that the merchandise referred to in the declaration was sold to the principal obligors under and according to the terms of certain agreements, not under seal, between them and the plaintiffs, entered into before and since the date of the bond, and not under or according to the terms of the

bond, which specified a credit of four months, and that he was thereby discharged.

The fourth separate plea of the said surety (R., 7) which the Court of Appeals erroneously designated a plea of set-off, and held bad, as such, for want of reasonable certainty, is neither in form nor in effect a plea of set-off. It alleges certain representations by the plaintiffs with the intent on their part thereby to induce him to become such surety. It was thus represented to him that under a certain agreement between the plaintiffs and the principal obligors, to which he was not a party, the plaintiffs were required to sell the merchandise in question for certain prices then specified in writing, but afterward, without his consent or knowledge, the plaintiffs entered into a new agreement with the principal obligors, increasing the prices; and as to the goods sold at such increased prices, the amount of which is specified in the plea, he claims to be thereby discharged.

The fifth separate plea of the said surety (R., 7, 8) alleges that the bond was entered into by him and was delivered upon certain conditions to be performed by the plaintiffs, but never performed by them, and that he was thereby discharged.

The sixth separate plea of the said surety (R., 8) alleges that the bond was delivered for the purpose of establishing and maintaining the business of the principal obligors as co-partners, and enabling them to deal in the goods of the plaintiffs, but that the plaintiffs, with the intent to secure to themselves the said business and to increase their profits by selling directly to the customers of Monaghan and McGuire, wrongfully enticed one of said co-partners, Monaghan, to withdraw from the copartnership and to enter the employ of the plaintiffs, and as their agent to sell their goods to said customers, and thus wholly destroyed said business, whereby the principal obligors were unable to pay for the goods sold them, and that the said surety was thereby discharged.

The foregoing pleas are identical with the six separate pleas of the surety, William McGuire, in the case of McGuire *et al.*, plaintiffs in error, vs. Gerstley *et al.*, No. 168, October Term, 1906, of this court, and were disposed of by the Court of Appeals upon the grounds stated in its opinion which is set out in the record in that case and to which reference is hereby made.

The seventh separate plea of the surety, Clark, sets up extension of credit, etc. No error is assigned as to the ruling of the Court of Appeals concerning this plea.

SPECIFICATION OF ERRORS.

The Court of Appeals erred as follows:

1. In holding that the 1st and 4th pleas were bad for want of reasonable certainty.

2. In holding that parol evidence to sustain the 2d, 3d and 5th pleas was inadmissible, and also in assuming that the defendant had none but parol evidence to adduce to sustain said pleas.

3. In holding that evidence in support of the 3d plea, and tending to prove that the merchandise was not purchased under or according to the terms of the bond, was inadmissible.

4. In holding that the 6th plea was either a plea of set-off or else of recoupment, and bad in substance.

5. In holding that each of the pleas demurred to was bad in substance, and in sustaining the demurrer thereto.

6. In refusing to hold that the declaration was defective in substance and insufficient on demurrer to sustain a judgment.

7. In affirming the judgment of the Supreme Court of the District of Columbia.

BRIEF OF ARGUMENT.

No point is now made concerning the seventh plea. The opinion of the Court of Appeals as to the six other pleas

is contained in the record in the case No. 168 at this term, at pages 16 to 22, inclusive, to which reference is made.

1ST SPECIFICATION OF ERRORS.

1. The 1st plea (R., 5-8) is a plea of set-off. The Court of Appeals held it insufficient to "inform the plaintiff, with reasonable certainty, of the particulars of the demand which he is called upon to defend" (R., 12: Case No. 168, R. 19).

The agreement mentioned is pleaded according to its legal effect, which is proper and sufficient.

1 Chit. Pl., 334.

The breaches are set out with sufficient certainty.

The damages claimed are such as may be presumed to result from the breach. Such damages are matter of evidence, and need not be alleged and are scarcely ever stated but in a general manner.

2 Johns. Rep., 149, Barruso vs. Madan;

1 Chit. Pl., 371.

Profits of such a business may be considered in damages.

1 Sedgw. Dam., Sec. 182.

2. The plaintiffs deny (R., 10) the right of a surety to set off a debt due his principal in an action against the principal and surety.

In this District, before the Code, such right of a surety was recognized. (See U. S. vs. West, 8 App. D. C., 59.) The Code D. C., section 1568, provides that "in an action against principal and sureties an indebtedness of the plaintiff to the principal may be set off as if he were the sole defendant."

But the broad terms of section 1563 of the Code fully justify the plea of set-off. That section permits claims under contract, whether "of the same or a different nature," including, among others, claims for unliquidated damages

for breach of contract "between *any* of the several defendants and the plaintiff," to be set off against each other by plea in bar.

Each claim of set-off may be considered as an action against the plaintiffs.

Code D. C., sec. 1565.

Statutes of set-off are to be liberally construed.

25 A. & E. Enc. (2d Ed.), 491.

A defendant may set-off his interest in a promissory note held by himself and another who is not a party to the suit.

22 Pa. St., 36, Smith & Co. vs. Myler & Aber.

5 Vt. 111 and other cases cited in 25 A. & E. Enc. (2d. Ed.), 523 and note 4.

3. The fourth plea (R., 7) was by the Court of Appeals (Case No. 168, R., 19, bottom), designated and dealt with as a plea of set-off; but it is not such in form or in effect. It is a plea of discharge and rests upon the theory that if the representations, made to him by the plaintiffs, as to the fact and the effect of the former agreement were true, the subsequent agreement so affected his liability as to discharge him.

1 Brandt, Sur. (3d Ed.), Secs. 255, 439.

77 Ga., 40, *infra.*

35 Vt., 476, *infra.*

2 Bland, Ch. R., 509.

On the other hand, if such representations were untrue, they operated as a fraud upon him and he would be thereby discharged.

77 Ga., 40, Marchman vs. Robertson.

2D AND 3D SPECIFICATIONS OF ERRORS.

1. The second plea (R., 6), sets up an agreement, preceding the bond, fixing the prices and terms; that this agree-

ment was the consideration for giving the bond; that the prices and terms were changed by subsequent agreements made without his consent or knowledge. The consideration was thereby destroyed and the surety discharged. This may be established by parol evidence.

77 Ga., 40, Marchman vs. Robertson.
35 Vt., 476, Hickock vs. Farmers', etc., Bank.
17 Ind., 126, Campbell vs. Gates.
88 S. W., 430, Moroney vs. Coombes.
54 Iowa, 684, Dicken vs. Morgan.
1 Brandt, Sur., 454.
5 Cyc., 742-744, 818.

2. The third plea (R., 6, 7) denies that the goods were sold on the terms provided in the bond (as to four months' credit), and alleges that they were sold on other terms and under certain agreements, not under seal, to which he was not a party. As to such goods, not sold on four months' credit, and therefore not contemplated by the bond, the surety was never liable. They were not within his contract.

1 Starkie, 192, Bacon vs. Chesney.
10 N. Y., 469, Leeds vs. Dunn.
1 Brandt, Sur., 140, 467.

In reference to the 3d specification of errors, it is to be observed that the plaintiffs were required to adduce evidence outside the bond as to the sale of the goods, quantity, prices, etc.; also that they were required to prove that the goods were sold on four months' credit as provided expressly by the bond. Therefore, it is unreasonable to say that the defendants, and particularly a surety, can not adduce other evidence to rebut the plaintiffs' proofs and show that the goods, or some of them, were sold, not on four months' credit, but on other terms as to time of payment, and therefore not within the bond.

In McMinn vs. Owen, 2 Dall., 173, proof was admitted

of a contemporaneous parol agreement that the instalment to be paid under the bond in suit should be paid in money current, when due.

The bond was by its terms intended to secure the plaintiffs to the amount of $5,000 for all goods sold by them to the principal obligors on four months' credit and for no other goods. The plea alleges that the goods in suit were not sold on the terms of the bond, but were sold under certain other agreements, etc.

Any dealings with the principal by the creditor which amount to a departure from the contract by which the surety is bound or which may affect his liability will discharge him.

1 Brandt, Sur., 439.

A creditor discharges a surety by any dealing or arrangement with the principal debtor without the surety's consent which at all varies the situation, rights, or remedies of the surety.

1 Brandt, Sur., 439.
2 Bland Ch. R., 509.

It is immaterial whether or not the change be beneficial to the surety.

24 How., 315;
9 Wall., 13;

3. The fifth plea alleges delivery upon conditions therein set forth, which were "known to and accepted by the plaintiffs," but which have never been performed. This operated as a discharge.

1 Brandt, Sur., 454.
17 Ind., 126, Campbell vs. Gates.
35 Vt., 476, Hickock vs. Farmers', etc., Bank.

4. The Court of Appeals (Case No. 168, R., 21) held that the bond, not being by any of its terms dependent upon

the agreements mentioned in these pleas, the relation between them must depend for its establishment upon parol evidence and that such evidence was inadmissible.

There is nothing in the pleas to justify the finding, or an inference that the surety was without written evidence to sustain the pleas. But parol evidence is admissible to show matter discharging a surety.

88 S. W. (Tex.), 430, Maroney vs. Coombes.
17 Ind., 126; 54 Iowa, 684 and other cases, *supra*.

4TH SPECIFICATION OF ERRORS.

The Court of Appeals held (Case No. 168, R., 19, 20) that the 6th separate plea of the surety was either a plea of set-off or else of recoupment, and as such, bad in substance; but it is not such in form or in effect. It is based upon the proposition that such misconduct on the part of the obligees in a bond, wilfully and maliciously preventing the performance of the condition of the bond and tantamount to fraud, will discharge a surety.

3 Ohio, 261, Trustees vs. Miller.
77 Ga., 40, *supra*.

The statement by the court (Case No. 168, R., 21) that this plea "has been argued in both aspects" (*i. e.*, set-off and recoupment) has no foundation in anything in the oral argument or brief on the part of counsel for the surety, who took the same position in that court as is taken in this brief in reference to said sixth plea.

5TH, 6TH AND 7TH SPECIFICATIONS OF ERRORS.

1. Upon demurrer, the court will go back to the first substantial defect appearing in the pleadings. In this case it is in the declaration itself. The plaintiffs filed a declaration, which does not set forth the terms of sale contemplated by the bond, and then they deny the right of the defendants

to prove what the terms were. This position is untenable.

The declaration alleges the bond was conditioned for the payment of *all* merchandise to be sold by the plaintiffs to the principal obligors, but the bond is expressly so limited as to cover only merchandise sold on four months' credit, and to exclude all merchandise sold on a longer, shorter, or any other term of credit.

Suppose, at a trial upon these pleadings, evidence were offered tending to prove that some or all of the merchandise in suit had been sold by the plaintiffs to the principal obligors upon six months' credit, or one month's credit, or under some contract or agreement other than the bond; would it not be error to exclude such evidence?

2. The facts stated in each plea are admitted by the demurrer as true. To hold a surety bound upon such a state of facts is contrary to elementary principles, to sound reason and to common honesty.

He does not seek to alter or modify, by parol proof, anything contained in the bond, but he does insist upon the right to establish by competent proof that for some, if not all, of the merchandise in suit he was never bound under the bond and also that by reason of the other matters alleged in his pleas he has been discharged from liability.

There was nothing in the bond requiring the principal obligors to pay in four months for *all* the goods they should purchase from the plaintiffs or preventing sales to them on other terms as to time of payment. The second and third separate pleas of the surety allege and the demurrer admits that the purchases were made on such other terms "and not under or according to" the terms of the bond, which recites an agreement to pay "in four months after the date of each respective purchase," and the condition is that the goods "so purchased" (meaning on four months' credit) shall be paid for "when and as" such payments "shall become due and payable."

In this connection, the case of Leeds vs. Dunn, 10 N. Y., 469, *supra,* is in point. One Woodcock, by letter, ordered goods of the plaintiffs, asking credit. Dr. Perrine in writing promised to pay the total amount if Woodcock failed to pay within six months after shipment. Dunn, in writing, declared himself equally responsible with Perrine. Plaintiffs shipped part of the goods on a credit of four months. In a suit against Dunn the court held that he was not "responsible for the payment of the goods to be sold Woodcock upon a credit of four and of six months, but for the goods to be sold all on a credit of six months."

In the case at bar one of the questions squarely presented is whether or not the bond covers goods which were not sold on four months' credit.

Lord Ellenborough held that "The claim as against a surety is *strictissimi juris,* and it is incumbent on the plaintiff to show that the terms of the guarantee have been strictly complied with. If I engage to guarantee, provided eighteen months credit be given, the party is not at liberty to give twelve only, and after the expiration of six more to call upon me."

Bacon vs. Chesney, 1 Starkie, 192.

In United States vs. Freel, 186 U. S. 309, 316, this court adopted the statement of Mr. Justice Story, in 9 Wheat., 680, "That the liability of a surety is not to be extended by implication, beyond the terms of his contract; that his undertaking is to receive a strict interpretation, and not to extend beyond the fair scope of its terms; and that the whole series of authorities proceeded upon this ground." To this, the court added, as an elementary proposition, that when the surety's "undertaking is to assure the performance of an existing contract, if any change is made in the requirements of such contract in matters of substance without his consent, his liability is extinguished."

The bond in suit is such an undertaking. The "existing

contract" to which it relates is referred to in the recital that the principal obligors "have bound and hereby bind themselves" to pay for the goods in four months after the date of each respective purchase. Although this made it necessary for the plaintiffs to allege and prove that the merchandise was purchased on those terms, the declaration is wholly silent on that point.

3. The principles declared in some of the cases above cited in support of the 2d, 3d, 4th and 5th specifications of errors, and particularly in reference to the 2d, 3d and 6th separate pleas of the surety, are as follows:

The engagement of a surety may be founded upon a consideration variant from that which induced its execution by his principal. If such consideration be a condition subsequent, to be performed by the creditor, his failure to perform it would operate as a fraud upon the surety and on that ground release him from all liability. Such defense, of failure of consideration, may be established by parol evidence and is not in conflict with the legal effect of his contract.

17 Ind., 126, Campbell vs. Gates.

Breach of a contemporaneous verbal agreement which constituted part of the consideration of a promissory note secured by mortgage, may be shown in defense, as failure of consideration, in a suit to foreclose the mortgage.

54 Iowa, 684, Dicken vs. Morgan.

A surety signed a promissory note upon the payee's promising that as soon as the note became due he would immediately proceed against the principal. For more than a year after the note became due the payee failed to sue the principal or to notify the surety, and meantime the principal became insolvent. Surety discharged.

35 Vt., 476, Hickock vs. Farmers' etc. Bank.

In a suit to foreclose a mortgage to secure payment of a note made by one Cook, the defendant, Mrs. Marchman, set

up in her answer that she was merely a surety for Cook; that she was induced to sign by false and fraudulent representations of the plaintiffs that they would furnish Cook with a certain fertilizer to sell in certain territory; that Cook had placed orders for 250 tons of the fertilizer but the plaintiffs had failed and refused to furnish Cook with the fertilizer which, if they had done, he would have been enabled to pay the note and save her harmless. *Held,* that this either increased her risk or showed fraud and, in either view, released her.

77 Ga., 40, Marchman vs. Robertson.

A lessee was required by the lease to make certain improvements. To secure performance of his covenants, he gave bond with surety. The condition of the bond contained a proviso that if the lessee should complete the improvements within four years the surety should be bound for the rent of the first year only. In a suit on the bond the defendant, surety, proved that after the expiration of the lease, but within the four years, the lessee was dispossessed by the plaintiffs, the lessors. *Held,* that the surety was liable for the first year's rent only, and it was immaterial whether or not the improvements were completed before the lessee was dispossessed because (within the time to perform) the obligees prevented performance.

3 Ohio, 261, Trustees vs. Miller.

A surety on a note may show, as matter of discharge, that part of the consideration for a mortgage, given by the principal debtor to secure payment of the note, was a contemporaneous parol agreement between the creditor and the principal debtor, unknown to the surety, that payment of the note should be extended for one year and the surety discharged. There was nothing on the face of the mortgage disclosing such an agreement. In such case it is not necessary to allege fraud, accident or mistake in order to render such evidence admissible.

88 S. W., 430, Moroney vs. Coombes.

A surety may show by parol evidence the consideration upon which he signed the bond and the failure of such consideration. Such failure will discharge the surety.

1 Brandt, Sur., Sec. 454.

4. Upon the whole record, it is respectfully submitted that the judgment should be reversed.

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